

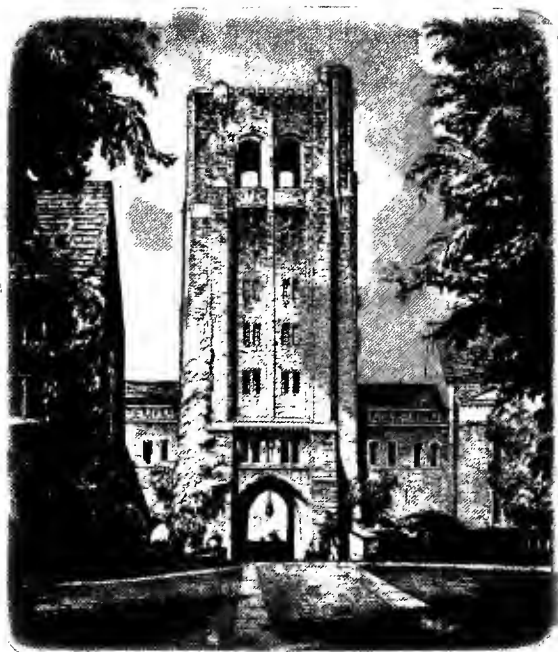
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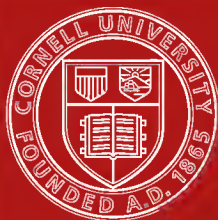
The transfer of negotiable paper as coll



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THE

TRANSFER OF NEGOTIABLE PAPER

AS

COLLATERAL SECURITY

BEING THE SHARSWOOD PRIZE ESSAY OF THE UNIVERSITY OF
PENNSYLVANIA FOR THE YEAR 1886, AND THE JOHNSON
PRIZE ESSAY FOR THE SAME YEAR.

BY

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III. RÉSUMÉ.

THE TRANSFER OF NEGOTIABLE PAPER AS COLLATERAL SECURITY.

I. GENERAL RULE FOR THE TRANSFER OF NEGOTIABLE PAPER.

THE object of this essay is to examine into the title of a creditor to negotiable paper which has been transferred to him as collateral security, and the grounds upon which this title has been asserted and denied; and to summarize, as far as may be, the inharmonious decisions of the various courts.

One almost universally accepted rule concerning the transfer of negotiable paper may be made a starting point. It is, that the transferee of such paper who receives it *bona fide*, before maturity, for a valuable consideration, and without notice of any latent defects in it, cannot be subjected to a defence arising out of these defects. What the law is concerning each of these prerequisites to a good title to commercial paper may be briefly and generally stated in the next few paragraphs.

And first, as to what constitutes *bona fides*. It is now a well-settled principle of law that mere negligence, however gross, is not sufficient to deprive a party of the character of a *bona fide* holder. There must be proof of bad faith.¹ And gross negligence has been defined as

¹ Phelan *vs.* Moss, 67 Pa. 59; Moorehead *vs.* Gilmore, 77 Pa. 118; Neeley *vs.* McSparran, 91 Id. 17; R. R. Co. *vs.* Nat. Bank, 102 U. S. 14; Chapman *vs.* Rose, 56 N. Y. 137; Smith *vs.* Livingston, 111 Mass. 343; Hamilton *vs.* Vought, 5 Vr. 187; Comstock *vs.* Hannah, 76 Ill. 530; Hooper *vs.* Bank, 47 Md. 88; Farrell *vs.* Lovett, 68 Me. 326; Green *vs.* Bickford, 60 N. H. 159; Frank *et al.* *vs.* Lilienfeld, 33 Gratt. 377.

consisting in the omission of that care which even inattentive and thoughtless men never fail to take of their own property.¹

This rule is coincident with the old English doctrine,² which was, however, repudiated in 1821, in *Gill vs. Cubitt*,³ Abbott, C. J., saying: "I think the sooner it is known that the case of *Lawson vs. Weston* is doubted, at least by this court, the better. I wish doubts had been cast on the case at an earlier time." The reign of *Gill vs. Cubitt* was a short one, for it was itself distinctly overruled by Lord Denman in *Goodman vs. Harvey*,⁴ and the former law reasserted. "We are all of the opinion," said that learned Judge, "that gross negligence, only, would not be a sufficient answer, where the party has given consideration for the bill; gross negligence may be evidence of *mala fides*, but it is not the same thing. We have shaken off the last remnant of the contrary doctrine. Where the bill has passed to the plaintiff without any proof of bad faith in him, there is no objection to his title."⁵

Bad faith, however, is susceptible of indirect proof. The notice which is sufficient to charge a holder with *mala fides* need not be direct and positive; it may be implied from the circumstances, provided those circumstances are clear and unequivocal. In the words of Baron Parke,⁶ "'Notice and knowledge' means not merely

¹ *Goodman vs. Simonds*, 20 How. 367.

² *Lawson vs. Weston*, 4 Esp. 56 (1801).

³ 3 B. & C. (10 Eng. Com. Law) 466.

⁴ 4 Ad. & El. (31 Eng. Com. Law) 870.

⁵ *V.*, also, *Uther vs. Rich*, 10 Ad. & El. (37 Eng. Com. Law) 784; *Bank vs. M'Leod*, 13 Jur. 945, and cases, *supra*.

⁶ *May vs. Chapman*, 16 M. & W. 355.

express notice, but knowledge, or the means of knowledge, to which the party wilfully shuts his eye.”

To charge a person with *mala fides*, therefore, in the transfer of commercial paper, there must be either direct proof or an irresistible implication that the party taking it had some knowledge or means of knowledge which he should have utilized, of defects of fraud or illegality in the title of the person with whom he is dealing. The presumption is in favor of the holder of the paper because of the rule of the mercantile law, that possession of commercial paper imports ownership.¹ When, however, proof of fraud or illegality is offered, the burden is shifted to the holder, and he must show that he received the paper *bona fide* for value.²

The second prerequisite of a good title to commercial paper is that the holder must have taken it before its maturity. The presumption in reference to such paper is that it will be paid at maturity. If not then paid, it may be because the maker is unable to pay, or unwilling at that time to pay, or that it has not been presented for payment, or because he has a good defence thereto. When past-due paper is put upon the market, the person to whom it is to be transferred must satisfy himself that none of these reasons exists; and failing to do so, he must meet the consequences of his negligence.³ The currency of the paper is not lost at its maturity, but is clogged with the equities of prior parties. The holder stands in the light of an assignee, rather than an in-

¹ *Coulson vs. Arnot*, 57 N. Y. 259; *Goodman vs. Simonds*, 20 How. 343.

² *Pugh vs. Grant*, 86 N. C. 39.

³ *Fox vs. The Bank*, 30 Kan. 441; *Perkins vs. Challis*, 1 N. H. 254.

dorsee in the usual course of trade;¹ and as such, is subject to antecedent equities; but by this is to be understood only such as attach to the particular paper, and, as between the parties, would be available to control, qualify or extinguish any rights arising thereon.² Thus a matter of set-off is unavailing as a defence to a suit on a note.³

Where no date is affixed to the indorsement of commercial paper, the law will presume that the indorsement was made at the date of the paper;⁴ or at least before its maturity.⁵

The principles which determine the degree of caution necessary to protect the holder of commercial paper, have already been presented in connection with the question of *bona fides*. The rule laid down by Lord Denman is now almost universal.⁶ Actual knowledge of any defects at the time of the transfer (except, sometimes, want of consideration in the case of accommodation paper, to be spoken of hereafter) will of course subject the holder to them. But beyond this, no circumstances, if not accompanied by *mala fides*, are considered sufficient to put the holder upon inquiry.⁷ The purchaser of commercial paper is not bound to be on the alert for circumstances which might excite the suspicions of wary vigilance. He does not owe the party who puts

¹ *Clay vs. Cottrell*, 18 Pa. 408; *Farrington vs. The Bank*, 39 Barb. 645; *Chester vs. Dorr*, 41 N. Y. 279.

² *Chester vs. Dorr*, *supra*; Story on Prom. Notes, § 178.

³ *Young vs. Shriner*, 80 Pa. 463.

⁴ *Tredwell vs. Blonnt*, 86 N. C. 33.

⁵ *Cisne vs. Chidester*, 85 Ill. 523; Daniel on Neg. Instr. § 728.

⁶ *V. cases*, *supra*; *Johnson vs. Way*, 27 Ohio, 374; *Maitland vs. The Bank*, 40 Md. 540.

⁷ *Brown vs. Spofford*, 95 U. S. 474.

the negotiable paper afloat the duty of active inquiry, in order to avert the imputation of bad faith. His rights are to be determined by the simple test of honesty and good faith and not by a speculative issue as to his diligence or negligence.¹ The rule moreover accords with the general spirit of the commercial law, which demands the utmost freedom in the currency of its paper.² If, at the time of every transfer of such paper, the purchaser was required, at his peril, to examine into its title, it would unquestionably result in forcing into an unmerited disuse this very convenient method which the debtor has of paying and securing his debt.

As a general rule, negotiable paper imports a consideration; the holder is presumed to be a holder for value,³ and the burden rests on the defendant to prove the contrary. This presumption cannot be rebutted by proof of want of consideration between the original parties.⁴ The defendant must prove that the paper was founded in fraud or illegality, or that it had been stolen.⁵ When, however, such a defence is made, the burden is shifted, and the plaintiff must show that he is a *bona fide* holder for value before maturity.⁶ The reason of this is, that there

¹ *Magee vs. Badger*, 34 N. Y. 249; *Bank vs. Hoge*, 35 N. Y. 65.

² *Moorehead vs. Gilmore*, 77 Pa. 118.

³ *Rideout vs. Bristow*, 1 Cr. & J. 231; *Daniel on Neg. Instr.* § 161.

⁴ *Knight vs. Pugh*, 4 W. & S. 445; *Dingman vs. Amsink*, 77 Pa. 114.

⁵ *Arbouin vs. Anderson*, 1 Q. B. (41 Eng. Com. Law) 498; *Hutchinson vs. Boggs*, 28 Pa. 294; *Collins vs. Gilbert*, 94 U. S. 278; *Sisternans vs. Field*, 9 Gray, 331; *Story on Prom. Notes*, § 196; *Daniel on Neg. Instr.* § 815; *Rice vs. Van Ackere*, 22 Ill. App. Cl. 592.

⁶ *Smith vs. Braine*, 16 Ad. & El. N. S. (71 Eng. Com. Law) 244; *Harvey vs. Towers*, 6 Exch. 660; *Catlin vs. Hansen*, 1 Duer, 323; *Perrin vs. Noyes*, 39 Me. 384; *Munro vs. Cooper*, 5 Pick. 412; *Gwyn vs. Lee*, 1 Md. Ch. 445.

is in such a case a presumption that the person who had been guilty of the illegality would dispose of the paper, and place it in the hands of another person to sue upon it; and, therefore, proof which gives rise to such a presumption casts upon the plaintiff the burden of showing that he is a *bona fide* indorsee for value.¹

What constitutes a valuable and sufficient consideration for the transfer of commercial paper is a more vexed question. If the paper is given in absolute payment and discharge of a debt, either past or presently created, the transferee acquires a good title.² But if instead of such absolute payment, the paper is transferred as collateral security or in conditional payment of a debt, the question becomes much more complicated.

This brings us to the subject matter of the essay.

THE TRANSFER OF NEGOTIABLE PAPER AS COLLATERAL.

Generally, the same rules as to *bona fides*, past-due paper and notice, apply as well to transfers for collateral as to transfers in payment. So, to avoid complication, we may assume, in what follows, that these three prerequisites are fully complied with. It is the apparent insufficiency, or even lack of *consideration*, which leads some of the Courts to deny the completeness of the title of a holder of collateral paper. Therefore by investigating the consideration for the transfer of such security, we are at the same time investigating, though indirectly, it is true, the title of the holder to it. For the transaction, being in the nature of a contract, its validity

¹ Bailey *vs.* Bidwell, 13 M. & W. 73.

² Swift *vs.* Tyson, 16 Pet. 1; Bardsley *vs.* Delp, 88 Pa. 420.

depends mainly upon the existence of a consideration for it. The subject may be conveniently divided into transfers as collateral, (1) for a debt created, or advances made, at the time of the transfer, (2) for future advances, (3) for an antecedent debt.

As to the first: It is generally conceded that when commercial paper is transferred as collateral security for a presently created debt, there is a sufficient consideration to validate the transaction and shut off the equities of the maker. While, of course, the debt itself is not the consideration (for if it were the transaction would be tantamount to a mere purchase of the paper), yet it is presumed that the debt would not have been created, or the loan made, except for the security.¹ So, in the every-day transaction of discounting notes, it is not unusual to ask for other notes as security for the ones discounted; and from the very demand for collaterals, it is manifest that the principal notes would not be discounted without them. The discount is made on the faith and credit of the collateral as well as of the principal notes.² The bank parts with its money or property upon the faith of both, and not upon the faith of one of them. If it is a holder for value of the principal security, so it is of the collateral. The two, in regard to the element of consideration, are inseparable.

2. When paper is transferred as collateral security for

¹ *Munn vs. McDonald*, 10 W. 270; *Miller vs. Pollock*, 99 Pa. 206; *R. R. Co. vs. Nat. Bank*, 102 U. S. 14; *Chicopee Bank vs. Chapin*, 8 Met. 40; *Griswold vs. Davis*, 31 Vt. 390; *Roseborough vs. Messick*, 6 Ohio St. 448; *Logan vs. Smith*, 62 Mo. 455; *Bank vs. Turnley*, 61 Tex. 365; *Winship vs. The Bank*, 42 Ark. 22; *Tucker vs. Bank*, 58 N. H. 83.

² *Miller vs. Pollock*, 99 Pa. 202; *Bank vs. Vanderhorst*, 32 N. Y. 557.

future advances, the same rule applies as in the case of a present loan. The transferee is therefore a holder for value.¹ And for much the same reason. The credit—the privilege of drawing upon the holder—is the consideration for the security, without which it is fair to presume the credit would be withdrawn. Such credit is therefore the moving cause for the transfer of the paper; it is a continuing liability, and consequently a good consideration.

3. There is a comparative uniformity in the decisions upon questions arising out of the two preceding classes of transfers. But that uniformity stops short of the decisions concerning commercial paper transferred as collateral security or in conditional payment for an antecedent debt. Yet even here, in certain cases, the weight of opinion is so strong that we may fairly premise some principles too well established to admit of much doubt. To avoid complication, this portion of the subject may be subdivided into (1) those cases in which the consideration for the transfer is patent or express, and (2) those cases in which the consideration, if there is any, is implied.

An express agreement to give time or to forbear pressing a claim has always been considered a sufficient and valid consideration; and where negotiable paper is transferred upon that agreement, the transferee is constituted a holder for value. The giving of time is a present and valuable consideration, and a pledge on these terms is the same as a pledge for money paid

¹ *Hecksher vs. Shoemaker*, 47 Pa. 249; *Williams vs. Smith*, 2 Hill, 301; *Agawam Bank vs. Strever*, 18 N. Y. 502; *Buchanan vs. The Bank*, 78 Ill. 500; *Morris vs. Preston*, 93 Ill. 215; *Bank vs. Turnley*, 61 Tex. 365.

down.¹ An agreement to forbear operates like a new loan of the amount of the debt due at the time of the transfer. The transaction is the same as if the old debt had been cancelled, and the sum paid had been loaned upon the paper transferred. The creditor parts with his right of action until the maturity of the paper, and assumes the risk of loss by the insolvency of his debtor in the meantime.²

When, at the time of the transfer of the collaterals, other securities are surrendered by the creditor, he is constituted a holder for value.³ The surrender of securities is said to be a valuable consideration as truly as the giving of money upon the faith of the collateral.⁴ Moreover, it is held, the surrender to a party of his own negotiable paper, and taking, in lieu thereof, a negotiable note before its maturity, is a sufficient parting with value to constitute a party a *bona fide* holder of the latter note.⁵ And it makes no difference whether the paper surrendered is past-due or not.⁶ Nor whether the original paper is actually delivered up, if only it be cancelled.⁷ Further,

¹ *Petrie vs. Clark*, 11 S. & R. 388; *Boyd vs. Cummings*, 17 N. Y. 101; *Jennison vs. Stafford*, 1 Cush. 168; *Robinson vs. Gould*, 11 Cush. 55; *Roseborough vs. Messick*, 6 Ohio, 448; *Bowman vs. Van-Kuren*, 29 Wis. 209; *Morton vs. Burn*, 7 Ad. & El. (34 Eng. Com. Law) 19; *Goodman vs. Simonds*, 20 How. 370; Com. Dig. Tit. Assumpsit B, 1; Story on Prom. Notes, § 186; Daniel on Neg. Instr.

² *Bank vs. Bradner*, 43 Barb. 392.

³ *Depeau vs. Waddington*, 6 Whart. 220; *Goodman vs. Simonds*, 20 How. 343; *Bank vs. Bentley*, 27 Minn. 87.

⁴ *Robbins vs. Richardson*, 2 Bosw. 252; *Ayrault vs. McQueen*, 32 Barb. 305.

⁵ *Youngs vs. Lee*, 12 N. Y. 551.

⁶ *Brown vs. Leavitt*, 31 N. Y. 113; *Pratt vs. Coman*, 37 N. Y. 440.

⁷ *Bank vs. Babcock*, 21 Wend. 449. The authority of these last cases remains undisturbed, but their reasoning has been criticised as

it makes no difference whether the instruments surrendered were held as collateral security or not.¹ As Rogers, J., said in *Depeau vs. Waddington*: "The reason that a negotiable note transferred as collateral does not constitute the holder a purchaser for value, is that he is supposed, although very often contrary to the fact, to be in no worse situation than he was before. But that is not the case where there is a new and distinct consideration, superinduced by the transfer and exchange of securities. It is not a past but a present consideration."

Therefore it will be seen that where time is expressly given or securities surrendered, the transferee of commercial paper as collateral is generally considered to be a holder for value. At this point, however, the uniformity of the cases ends. They divide themselves, speaking generally, into two rather distinct classes, the one led by the New York and Pennsylvania authorities, the other by those of the English courts and the Supreme Court of the United States. The issue between them, as usually stated, is that a pre-existing debt is or is not a sufficient consideration for the transfer of negotiable paper as collateral security. This is manifestly inexact, and is not what is meant by the Courts expressing themselves so. Certainly, a past debt of itself is not a consideration for a present transaction. What is past, without more, is not a consideration at all. What is meant is, that the pre-existing debt has or has not such a present and continuing force that the creditor has the privilege of recovering it at any time out of the estate of

rather technical than substantial, and an extension of the rule established by them denied. *Ins. Co. vs. Church*, 81 N. Y. 218.

¹ *Depeau vs. Waddington*, *supra*; *Goodman vs. Simonds*, *supra*; *Hornblower vs. Proud*, 2 B. & Ald. 327; *Rideout vs. Bristow*, 1 Cr. & J. 231.

his debtor, and that his *forbearing* to do so constitutes the consideration for the transfer of the collateral. We must look, therefore, into the doctrine of forbearance if we would have any hope of facilitating the solution of the question.

Omitting, for the moment, the consideration of the force which the negotiability of certain written promises has as an element in the question, let us recur to the more underlying principles of forbearance.

It is well established that where, in consideration of a promise by one person to pay the debt of another, the promisee expressly agreed to forbear pressing his claim, or actually forbore in consequence of an express request by the promisor, the forbearance constituted a good consideration, sufficient to support a recovery, by the forbearing promisee, upon the promise to pay. In these cases the agreement to forbear on the one hand, and the request for forbearance on the other, are express. Now let us look at the cases where there is no express agreement to forbear nor any express request for forbearance.

It may be premised that mere forbearance to sue, without any agreement to that effect, is not a sufficient consideration for the promise of another to pay the debt of the person originally liable.¹ And mere forbearance, which is not the consequence of the request of him who promises to pay the debt, is equally valueless as a consideration, for, in either case, the forbearance is a mere gratuity.² If, on the other hand, the forbearance can be shown to have been induced by the promise to pay, it

¹ *Clark vs. Russell*, 3 Watts, 213; *Mecorney vs. Stanley*, 8 Cush. 85; *Mantner vs. Churchill*, 127 Mass. 31; *Perkins vs. Proud*, 62 Barb. 420; *Crofts vs. Beale*, 11 C. B. (73 Eng. Com. Law) 171.

² *Bixler vs. Ream*, 3 P. & W. 285.

ceases to be a mere benefaction, and becomes a good consideration. It is immaterial, moreover, for what time the creditor forbears—it may be for a year or for a single day.¹ In any event, there are but two elements which are needed to constitute the forbearance a good consideration, namely, its having actually occurred, and its inducement by the promise to pay. Now this inducement may be express or implied. If it is express, there is no difficulty in the question, there being present and patent all the essentials of a contract. But on the other hand, if the inducement is to be implied, and how that implication can arise, are points concerning which the cases show a distressing want of harmony.

Ordinarily, if A. owes B. a debt, and C. gives B. a parol promise (not in the form of negotiable paper) to pay it, the promise is void for want of consideration.² This seems to be the rule also where, subsequent to the acceptance of C.'s promise, B. forbore to press his claim against A.³ For the forbearance in such case was a mere gratuity, and was not an element in the contract. B. was not expected to forbear, nor was he induced to do so by C.'s promise. His forbearance was only a benefaction, an uncalled-for leniency towards his debtor.

If, however, it can be shown that the creditor's forbearance is the consequence of the promise of the third person, it then has a function to perform in the contract. It relates back to the inception of the promise and becomes the consideration for the obligation to pay. Of course, if the creditor expressly binds himself to forbear, the relation of cause and effect between his subsequent

¹ 2 Am. L. C. 227, and cases.

² Clark *vs.* Russell, *supra*; Mantner *vs.* Churchill, 127 Mass. 31; Crofts *vs.* Beale, 11 C. B. O. S. (73 Eng. Com. Law) 171.

³ Bixler *vs.* Ream, *supra*.

forbearance and the promise of the third person to pay, is patent and needs no proof; but as Judge Gibson said in *Clark vs. Russell*, "it is not essential that the creditor should have *bound* himself to forbear or stay proceedings on the original security so as to give an action for a breach of promise. Such an agreement would undoubtedly be a good consideration, and might be so laid, according to the precedents in cases of mutual promises which are reciprocally the consideration of each other, and which must therefore be simultaneous, concurrent, and equally obligatory; but where the consideration is not promise for promise, less than a positive engagement to do an act which, when done, is to be the meritorious cause of the promise, may be a sufficient consideration for it. . . . If I promise my neighbor to compensate him if he will do a specific act of service for me, and he does it in consequence, he may maintain an action though he had not bound himself to do it. The consideration of such promise belongs to the class called executory, the promise being in its nature conditional. . . . The condition of forbearance belongs to the executory class, and differs in no particular from the instance put, except that the act is of a negative instead of an affirmative nature."

The request for forbearance, however, need not be expressly stated; but, when followed by the actual withholding of the creditor's rights of collection, may, under certain conditions, be presumed.¹ One of these conditions, and the only one which it is the province of this essay to treat, is when the promise of the third person

¹ *Breed vs. Hillhouse*, 7 Conn. 523; *Wheeler vs. Slocumb*, 16 Pick. 52; *Boyd vs. Freize*, 5 Gray, 553; *Happy vs. Mosher*, 48 N. Y. 313; *Cox vs. Keiser*, 15 Brad. 432; *Wilbur vs. Jernegan*, 11 R. I. 113; *Goodman vs. Simonds*, 20 How. 343; *Baker vs. Walker*, 14 M. & W. 465; *Popplewell vs. Wilson*, 1 Str. 264; *Chitty on Contr.* 1134.

is put in the form of negotiable paper; as in the case of a promissory note or an acceptance of a bill of exchange. Omitting for the present the consideration of such commercial paper as matures immediately after its inception, *i. e.*, demand notes, checks, etc., our inquiry may be as to whether paper on time gives rise to a presumption *post hoc ergo propter hoc*, as respects the subsequent forbearance. We therefore have this case: A. owes B. a debt, and C. gives him (B.) his note, say for ninety days, and B. refrains from pressing his claim for that length of time. At the expiration of the ninety days he sues C. on his note. Now, can it be said that the note bore with it such an implied request for forbearance that, when B. actually forbore, his forbearance was a consequence of the request and a good consideration for the transfer? There is abundant authority to answer the question affirmatively.¹ One of the alternative essentials of a good consideration, namely, a detriment to the promisee, is present in these cases. As Lord Ellenborough said in *Gould vs. Robson*,² "how can a man be said not to be injured if his means of suing be abridged by the act of another?" So, where a man who has a judgment, takes from his debtor a promissory note for the amount payable at a certain time, it must be inferred that he thereby enters into an agreement to suspend his remedy for that period, and, if so, that is a good consideration for the giving of the note.³ And if there be a guarantor or surety on the original debt, he is discharged by the

¹ *Kendrick vs. Lomax*, 2 C. & J. 405; *Gould vs. Robson*, 8 East, 576; *Walton vs. Mascal*, 13 M. & W. 452; *Baker vs. Walker*, *supra*; *Price vs. Price*, 16 M. & W. 232; *Kearslake vs. Morgan*, 5 T. R. 513; *Stedman vs. Good*, 1 Esp. 4; *Okie vs. Spencer*, 2 Whart. 259; *Myers vs. Welles*, 5 Hill, 464.

² 8 East 576.

³ *Baker vs. Walker*, *supra*.

giving of time to his principal; so that whether he is released or not affords a test of great sensitiveness as to whether the indulgence was intended to be granted or not by the receipt of the negotiable security. So where the holder of a promissory note, on the day that it became due, accepted from the maker a check, drawn upon a bank, by a firm consisting of the maker and a third person, dated six days afterwards, which check was to be in full satisfaction of the note in case it was paid at maturity, it was held that this amounted to a suspension of the remedy against the maker and discharged the indorser.¹ Kennedy J. said, "that the holder by accepting the check, put it out of his power to proceed on the note by suit against the drawer, until after the six days, cannot, as it appears to me, be controverted upon any ground that would seem consistent with the nature of the transaction, and what must have been the intent of the parties. Had the drawer given his own check merely, for the payment of the note at the expiration of the six days, there might have been some color for saying that the holder had not thereby precluded himself from bringing suit on it during that period; . . . and that he had obtained by it no additional security, and consequently no adequate consideration to make a promise of indulgence binding: . . . but the holder of the note received the additional responsibility of M. as security for the payment of it, and it would therefore seem almost impossible to imagine any other reason for giving such additional security than that of procuring an extension of payment for the six days."

Thus it appears that when such negotiable paper is

¹ *Okie vs. Spencer*, 2 Wharton, 252.

transferred to a creditor and he subsequently forbears to bring suit, there arises a presumption that his forbearance is the result of the transfer of the paper and therefore a good consideration for it. And such a presumption is a reasonable one, because in the great majority of such transactions, commercial paper is transferred merely to gain the indulgence of creditors. Business men are not prone to deal in benefactions towards each other, and to assume such a transfer to be a mere gratuity would be to make an assumption at variance with both sound reason and every-day experience.

The general rule has been stated to be that forbearance, though following a promise, is usually not presumed to be induced by that promise and is therefore no consideration for it. The general rule meets with an exception in the case of commercial paper, from the giving of which a request for indulgence is generally implied, which when followed by forbearance, is presumed to be its cause; thus completing all the elements of a valid contract with an executory consideration. If now, this exception was universal, the position of those Courts which have adopted the rule of the Supreme Court of the United States, that the transferee of collateral for an antecedent debt is a holder for value, would unquestionably be the correct one. But there is an exception to the exception behind which the opposite rule takes shelter, namely, that while negotiable paper gives rise to an implication of forbearance when transferred in conditional payment of a debt, yet that is not the case when it is transferred as collateral security merely¹. Between the two positions there seems to be an irreconcilable difference.

In *Pring vs. Clarkson*², Abbott C. J. held, that in no

¹ *Austin vs. Curtis*, 26 Vt. 64. ² 1 B. & C. 8 Eng. Com. Law, 10.

case had it been said that the taking of a new bill payable on time as collateral security, from the acceptor, should have the effect of giving time on the first bill. So where a note was transferred as collateral security to a mortgage an agreement to give time on the latter could not be implied from the postponed day of payment of the note.¹ A very clear exposition of the theory of this line of decisions is given in *Fenouille vs. Hamilton*,² where Walker C. J., said "in this case there was no other consideration for the transfer of the note of the defendant than the security of the pre-existing indebtedness of the defendant's indorser. The fact that the defendant may have been led to grant indulgence, or forbear to enforce his remedies for the collection of his debts, does not prove that such indulgence or forbearance was an element of the contract or the consideration upon which it was made. If there was any forbearance by the defendant, it was a voluntary act to which he may have been persuaded by the collateral security and which may have resulted from a consciousness of security; but such forbearance was not the result of the contract and is not shown to have been the consideration for it." Consideration like every part of the contract must be the result of agreement. It must appear that the parties were influenced to the particular action by something of value, of convenience or of inconvenience recognized by all of them as the moving cause. That which was a mere fortuitous result flowing accidentally from an arrangement, could not be a legal consideration.³ In accordance with this theory therefore the mere transfer

¹ *Gahn vs. Niemcewicz*, 14 Johns. 312.

² 35 Ala. 323.

³ 4 Har. 117; *V.*, also, *Petrie vs. Clark*, 11 S. & R. 377; *Bone vs. Tharp*, 63 Ia. 223; *Boykin vs. Bank*, 72 Ala. 262; *Richardson vs. Rice*, 9 Bax. 270.

of collateral raises no presumption of a stipulation for further time to pay a pre-existing debt.¹

But while these cases deny that any implication of forbearance arises in the transfer of collateral security merely, yet they concede that the case is different where there is a transfer in conditional payment, which is the agreement of the parties that if the paper is paid at maturity, it shall be a full satisfaction of the debt. There arises an implied obligation on the part of the creditor to wait until the maturity of the paper for the payment of his debt.²

The distinction between transfers as collateral and in conditional payment seems to be that, in the latter, the creditor is absolutely precluded from enforcing his claim until the maturity of the paper; while in the former he may bring suit at any time, bringing his collaterals with him into court. While the distinction may be sound, it is a little difficult to see what bearing it has on the question of forbearance as a good consideration. If I promise to give \$1000 if somebody will build me a house, and B. builds it for me, there is no doubt that I would be liable; and yet there was no obligation on B. to build the house. So where I request forbearance of my creditor, and he forbears, though there is no binding obligation on him to forbear, yet his forbearance ought analogously to be deemed a good consideration. So it would seem that whether forbearance is compulsory or not is an imma-

¹ *Bowman vs. VanKuren*, 29 Wis. 209; *Stalker vs. M'Donald*, 6 Hill 93; 2 Am. L. C. 226.

² *Stedman vs. Gooch*, 1 Esp. 4; *Gould vs. Robson*, 8 East, 596; *Price vs. Price*; 16 M. & W. 231, 239; *Myers vs. Welles*, 5 Hill, 463; *Belshaw vs. Bush*, 11 C. B. (73 Eng. Com. Laws) 191; *Ins. Co. vs. Allen*, 11 Mich. 501; *Austin vs. Curtis*, 31 Vt. 64; *Okie vs. Spencer*, 2 Wharton, 252.

terial question with respect to consideration. The essential part of the transaction is, whether a request for forbearance can be implied; and not whether, supposing such an implication, the forbearance is compulsory or not.¹

The English cases have seemed to ignore the distinction between collateral security and conditional payment.² The case of *Crofts vs. Beale*,² which seems to recognize distinctly the difference between the transactions, was, it is to be noticed, a case of a non-negotiable note.³ In *Currie vs. Misa*,⁴ where a check was transferred as collateral, the Court said that the true ground for the decision of the case was to consider the check (a collateral security) as having been given in conditional payment; but yet, not holding that the creditor was bound by the acceptance of the check to forbear, as indeed he could not, as the check was demand paper, and to wait until its maturity was not to wait at all.⁵ Therefore the transferee of negotiable paper as collateral security is, in the light of these decisions, a holder for value.⁶

The American decisions, as has been stated, are inhar-

¹ *Boyd vs. Freize*, 5 Gray, 553; *Currie vs. Misa*, L. R. 10 Ex. 153; *Alliance Bank vs. Broom*, 2 Drew & Sm. 289.

² *Popplewell vs. Wilson*, 1 Str. 264; *Rideout vs. Bristow*, 1 Tyr. 84; 1 C. & J. 231; *Baker vs. Walker*, 14 M. & W. 465.

³ 11 C. B. 73 (Eng. Com. Law) 171.

⁴ *V.*, also, *Benshaw vs. Bush*, 11 C. B. (73 Eng. Com. Law) 191; *Poirer vs. Morris*, 2 El. & Bl. (76 Eng. Com. Law) 89; *Currie vs. Misa*, L. R. 10 Exch. 153; 1 App. Cas. 554.

⁵ *Leask vs. Scott*, 2 Q. B. Div. 37.

⁶ *Bosanquet vs. Dudman*, 1 Stark. 1; *Heywood vs. Watson*, 4 Bing. (13 Eng. Com. Law) 496; *Percival vs. Frampton*, 1 C. M. & R. 180; *Bosanquet vs. Forster*, 9 C. & P. (38 Eng. Com. Law) 277; *Poirer vs. Morris*, *supra*.

monious. Some hold that there is no distinction in principle between transfers in payment and transfers as collateral security;¹ while others decide that the distinction is a valid and necessary one;² and in a great majority of the cases the distinction is not mentioned in terms.

There are, then, the three classes of decisions—where a title is protected in the case of either sort of transfer; where the title is protected in the case of transfers in conditional payment, but not as collateral; and third, where the title is protected in neither case. The middle position is illogical and inconsistent, and is not supported by the best authority. So, omitting it from the discussion, we may proceed to a further consideration of the other two classes. The leading case of the latter class is *Bay vs. Coddington*.³ The facts of the case were: R. and S. held certain notes belonging to the defendant, and were at the time largely indebted to the plaintiffs. They became insolvent, and assigned these notes as collateral security for their indebtedness. It is to be noticed that this insolvency was known to the plaintiffs. Chancellor Kent held that “the notes were not negotiated to the plaintiffs in the usual course of business or trade, nor in payment of any antecedent or existing debt, nor for cash or property advanced, debt created or responsibility incurred on the strength and credit of the notes. They were received from R. and S., and after they had stopped payment, and had become insolvent within the knowl-

¹ *Okie vs. Spencer*, 2 Whart. 253; *Weakley vs. Ball*, 9 Watts, 273; *Meadew vs. Bird*, 22 Ga. 254; *Gibson vs. Connor*, 3 Kelly, 47; *Butters vs. Houghwort*, 42 Ill. 18; *Atkinson vs. Brooks*, 26 Vt. 576; *Giavanovich vs. Bank*, 26 L. Ann. 15; 14 Am. L. Rev. 481.

² *Austin vs. Curtis*, 31 Vt. 64.

³ 5 Johns. Ch. 54, aff'm'd, 20 Johns. 637.

edge of the plaintiffs, and were seized by them as *tabula in naufragio* to secure themselves against contingent engagements previously made for R. and S., and on which they had not then become chargeable. There is not a case which entitles such holder to the paper in opposition to the title of the true owner. They were not holders for a valuable consideration within the meaning and within the policy of the law. It is the credit given to the paper and the consideration *bona fide* paid on receiving it that entitles the holder on grounds of commercial policy, to such extraordinary protection, even in the cases of the most palpable fraud. It is an exception to the general rule of law, and ought not to be carried beyond the necessity which created it." This case has been followed in a great many States, although there is reason to believe that Chancellor Kent subsequently rejected his conclusions arrived at there.¹ The decisions favoring this view are in the main a reassertion of the reasoning of *Bay vs. Coddington*, and a denial of the existence of consideration in the transfers as collateral. Whatever force this reasoning may have, however, it seems less cogent and satisfactory than that of the Courts following Judge Story's dictum in *Swift vs. Tyson*.² In the latter case it was said: "Assuming it to be true (which, however, may well admit of some doubt from the generality of the language), that the holder of a negotiable instrument is unaffected with the equities between the antecedent parties, of which he has no notice, only where he received it in the usual course of trade and business, and for a valuable consideration, before it becomes due; we are prepared to say that, receiving it in payment of, or as a security for a pre-

¹ 3 Kent Com. *81.

² 16 Peters, 1.

existing debt, is according to the known usual course of trade and business. And why upon principle should not a pre-existing debt be deemed such a valuable consideration? It is for the benefit and convenience of the commercial world to give as wide an extent as practicable to the credit and circulation of negotiable paper, that it may pass not only as security for new purchases and advances made upon the transfer thereof, but also in payment of and as security for pre-existing debts."

It is often quite as important to business men in commercial transactions, that they should be able to secure their debts, and make use of current paper for that purpose, as it is that they should make new purchases, or sell such paper, sometimes at ruinous sacrifices, for the purpose of raising money with which to pay their debts.¹ It is therefore regarded that the forbearance which is gained by the transfer of the security is as well a benefit to the debtor, as a detriment to the creditor. This fortifies the position of the holder with another sort of consideration, and elucidates the reason why the forbearance need not be compulsory to constitute a good consideration. In *Bank vs. Chambers*,² the reason why a transferee of negotiable paper as collateral was to be considered a holder for value, was stated to be, that the creditor was thereby enabled to realize or secure his debt; and could thus give a prolonged credit, or forbear from taking any legal steps to enforce his rights, while the debtor had all the advantage of making his negotiable securities of equal value to cash.

It is frequently stated that an *agreement* to forbear can or cannot be implied from the transaction.³ This is

¹ *Bank vs. Carrington*, 5 R. I. 521.

² 11 Rich. S. C. 661.

³ *Mantner vs. Churchill*, 127 Mass. 31; *Manning vs. McClure*, 36 Ill. 496.

an inaccurate and unscientific expression of the nature of what is to be implied, but is tantamount to saying that there can or cannot be implied a *request* for forbearance. In *Manning vs. McClure*,¹ it is said "it is assumed that because the creditor does not expressly agree to give time he does not in fact give it; he does not forbear to use remedies that he would have used but for the security. Now the question is one of presumption, and that presumption must be drawn from the general experience of society. The question is, in the absence of any express agreement, what we must presume to have been the implied understanding of the parties at the time of the indorsement, in regard to further forbearance to be inferred from the nature of the transaction, and the objects which both parties had in view. We have no hesitation in saying that the assumption that time is not in fact given because it is not expressly agreed to be given, and that therefore the endorsee is not placed in a worse position by letting in the latent equities than he would have occupied if he had not received the note, is at variance with the general experience of all men whose business makes them cognizant of affairs of this character." The necessity of maintaining that collateral security is transferred on a good consideration is more apparent in the new States, where the uncertain condition of property, and the fluctuations in titles and pecuniary affairs make collateral security there more valuable than elsewhere, and the loss of it more frequently equivalent to the loss of the debt. A man receiving such security, and suspending his proceedings to collect the debt, would often find that he had lost the debt by taking the

¹ 36 Ill. 496.

security, if defences could be set up against the paper.¹ The same remarks are quite as applicable to periods of commercial disaster and panic, following in the wake of speculation, which are sometimes experienced in the more settled Commonwealths.

The same general principle has been confirmed in a recent case in the Supreme Court of the United States,² which puts to rest all doubts concerning that Court's position. Judge Story's dictum in *Swift vs. Tyson* was cited with unqualified approval. In an elaborate opinion Mr. Justice Clifford made a careful review of the English authorities, and came to the conclusion that those authorities were sufficient to show that there is but one voice upon the subject in the Courts of the parent country, and that they speak to the point with a degree of uniformity and unanimity well calculated to excite admiration and inspire confidence that the rule of decision is both correct and just. Not only every Court, but every judge of every Court in that country, concurs in the proposition that the holder of such a negotiable security, before maturity, as collateral to a pre-existing debt, without notice of any prior equities, is a *bona fide* holder for value in the usual course of business, and that his title to the instrument is good, and wholly unaffected by any such prior equities between the antecedent parties. Text-writers everywhere, adopt the same rule and recognize and commend it as the true rule of decision.³

There yet remains to consider, under this sub-division of the subject, the question of paper payable on demand.

¹ *Robinson vs. Smith*, 14 Cal. 98.

² *R. R. Co. vs. Nat. Bank*, 102 U. S. 14.

³ *Chitty on Bills*, 13 ed., 74 ; *Story on Bills*, 4 ed., 193 ; *Id. on Prom. Notes*, 7 ed., §§ 195-6 ; *Byles on Bills*, 5 Am. ed., 369 ; *Daniel on Neg. Instr.* §§ 827-830, 3 Kent. Com. *81.

Assuming that the position of the Supreme Court of the United States is the correct one as regards paper payable at a future date, yet it is by no means a question without doubt whether that doctrine will extend to demand paper. If the ground for that position is the request for forbearance which is implied from the acceptance of the paper, yet why should such an implication arise from the acceptance of paper payable at once? An answer to this question may be found in the fact that in mercantile transactions, it is not expected that the paper will be presented for payment at once, nor indeed until the lapse of what has been termed a reasonable time after date,¹ and what is a reasonable time is a question of law, if the facts be agreed upon.² If, however, the demand note bears interest, it is a continuing security and is not to be considered as over-due without some evidence that payment has been demanded and refused.³ The English rule seems to dispense with the necessity of interest, in order to constitute it a continuing security.⁴ "A common promissory note payable on demand is often originally intended as a continuing security and afterwards indorsed as such. Indeed it is not uncommon for the payee, and afterwards the indorsee, to receive from the maker, interest periodically, for many years on such a note, and sometimes the note is expressly made payable with interest, which clearly indicates the intention of the parties to be that, though the holder may demand payment im-

¹ *Herrick vs. Wolverton*, 41 N. Y. 581; *Merritt vs. Todd*, 23 N. Y. 28; *Bacon vs. Harris*, 15 R. I. 599.

² *Furman vs. Haskin*, 2 Cai. 372.

³ *Wright vs. Leibert*, 4 Phila. 54; *Lockwood vs. Crawford*, 18 Conn. 361.

⁴ *Byles on Bills*, 131; *Brooks vs. Mitchell*, 9 M. & W. 15.

mediately, yet he is not bound to do so."¹ Interest could accrue only from forbearance of payment.²

There is by no means an unbroken chain of authorities on the subject of demand paper; but it is not thought necessary to go into a detailed comparison of them. In so far as it is to be treated as collateral security, it is governed by much the same principles as paper payable at a future date. From the cases already cited, it is manifest that in many, if not in the majority of instances, where demand paper is given, it is no more the intention of the parties to have the paper presented at once, than if it had been payable in six months. The distinction, therefore, between the two kinds of paper, as implying a request for forbearance, is not an essential one; on the contrary it is said to be so immaterial as to be at variance with the general understanding of mercantile men.³

This concludes the discussion of the first species of consideration which is said to be present at transfers as collateral. We now proceed with the other.

When a creditor receives negotiable paper from his debtor, it becomes his duty to present it for payment when due, and to take proper steps to charge the indorsers; and failing to do this, he makes the paper his own.⁴ The fair construction of the contract of the parties is that the creditor will use proper diligence in the collection of the security and will account for the same; and he is certainly forbidden such negligence as shall produce loss to the debtor who transfers the paper to him.⁵ The

¹ *Brooks vs. Mitchell*, 9 M. & W. 15.

² *Lockwood vs. Crawford*, 18 Conn. 361.

³ *Currie vs. Misa*, L. R. 10 Ex. 153.

⁴ *Jennison vs. Parker*, 7 Mich. 355; *Peacock vs. Pursell*, 14 C. B. N. S. (108 Eng. Com. Law) 728; *Allen vs. King*, 4 McL. 128.

⁵ *Betterton vs. Roope*, 3 Lea, 215.

creditor is bound to preserve and collect the collateral and apply it for the benefit of the transferor. He must not waste it, nor exchange it for an inferior security, and doing either, he makes himself accountable for it.¹ The transferee is invested with the ownership of the collateral for all purposes of dominion over it.² And if the debt is paid or a suit brought for it, the creditor is bound either to produce the collateral or account satisfactorily for its non-production; and he cannot escape the duty by showing that the collateral security, subsequent to its deposit, had become worthless, since *non constat* but that he may have disposed of it to advantage while it was still of value.³ In *The Railroad Co. vs. National Bank*,⁴ Mr. Justice Harlan said "another ground upon which some Courts have declined to sanction the rule announced in *Swift vs. Tyson* is, that upon the transfer of negotiable paper merely as collateral security for an antecedent debt, nothing is surrendered by the indorsee, that to permit the equities between prior parties to prevail, deprives him of no right or advantage enjoyed at the time of the transfer; imposes on him no additional burdens, and subjects him to no additional inconveniences. This may be true in some, but is not true in most cases; nor, in our opinion, is it ever true when the note, upon its delivery to the transferee, is in such form as to make him a party to the instrument, and impose upon him the duties which according to the commercial law must be discharged by the holder of negotiable paper in order to fix liability upon the indorser. . . . The bank received the note, under an obligation imposed by the commercial law, to present it for payment, and give

¹ *Kirkpatrick vs. Muirhead*, 45 Pa. 237.

² *McQueen's App.*, 104 Pa. 602. ³ *Stuart vs. Bigler*, 98 Pa. 80.

⁴ 102 U. S. 27.

notice of non-payment, in the mode prescribed by the settled mode of that law. We are of opinion that the undertaking of the bank to fix the liability of prior parties by due presentation for payment, and due notice in case of non-payment, an undertaking necessarily implied by becoming a party to the instrument, was a sufficient consideration to protect it against equities existing between the other parties of which it had no notice."¹ The law which requires presentment of commercial paper at maturity, and notice in case of dishonor, is rigorous and exacting. The holder must demand payment on the third day of grace, and upon his neglect so to do, all the parties to the note except the maker are discharged. Applying this well-recognized rule to the case of a note transferred as collateral, it will be seen that, if the holder fails to make presentment, his debtor being an indorser is discharged. The least effect of this is that the debt is discharged. It would seem idle, therefore, if such is the case, to discuss further the reasonableness or unreasonableness of the position of the Supreme Court of the United States. Apart from the question of expediency, it would seem that, in accordance with the strictest precedential rules of consideration, such a transaction forces on the creditor a risk, a detriment, and that too at the very moment of the transfer, which, briefly, is a good consideration.

Thus far, the discussion of the subject has been mostly confined to the influence of the common law rule of consideration upon it. But a good title in the holder of negotiable paper has been accounted for on another ground, namely, that the currency of the paper is itself

¹ *Bank vs. Bank*, 8 Barb. 396; *Swift vs. Tyson*, 16 Pet. 1.

sufficient to carry the title to a *bona fide* transferee.¹ According to this theory, it is deemed more just that the person who signs his name to a negotiable note, knowing that it is to circulate, if not as money, yet in the manner of money, should suffer the consequences of his act.² The force of the analogy between negotiable paper and money is more clearly seen in the comparison of a negotiable note to a bank-note. The difference between these two instruments is not one of kind, but of the certainty or uncertainty of ultimate payment. Yet no one will deny that a bank-note is money. There have been times when the paper of individual merchants was as valuable and creditable as the paper of the government, and yet the latter is always called money by the Courts. That money, however, in its broadest sense is not limited to what is stamped with the seal of government, but includes everything which passes current in representation of capital, is a truth which leading economists seem ready to recognize.

The similarity between those two species of negotiable paper, however, is still more plainly seen by reference to the early case of *Miller vs. Race*,³ decided when bank-notes were not indisputably money. Lord Mansfield said "bank-notes are not goods, not securities, nor documents for debts, not are so esteemed, but they are treated as *money*, as *cash*, in the ordinary course and transaction of business, by the general consent of mankind, which gives them the credit and currency of *money*, to all intents and purposes." The same judge extended the doctrine just stated to bills of exchange in *Peacock vs. Rhodes*.⁴ "The

¹ *People's Bank vs. Bates*, 120 U. S. 564.

² *Bank vs. Carrington*, 5 R. I. 522; *Fearing vs. Clark*, 16 Gray 76.

³ 1 Burr. 452 (1758).

⁴ 2 Doug. 633 (1781).

holder of a promissory note," said he, "is not to be considered in the light of an assignee of the payee. An assignee must take the thing assigned subject to all the equity to which the original party was subject. If this rule applied to bills and promissory notes, it would stop their currency. The law is settled that a holder coming fairly by a bill or note has nothing to do with the transaction between the original parties." The maxim "*nemo dat quod non habet* therefore meets with an exception in negotiable paper, which, being part of the currency, is subject to the same rule as money.¹ According to this theory, then, negotiable paper, which passes by delivery, is treated as a species of money, which the necessities of trade require and therefore render current.² If the principle of the theory is adopted, it practically dispenses with the necessity of a consideration in all transactions involving the negotiation of commercial paper; and perhaps this has been the tendency of the law merchant, demanding, as it does, the utmost freedom and facility in its transactions. Whether or not the development of that law will eventuate in the subversion or at least in the modification of the common law doctrine of consideration, and in a consequent recognition of the sounder teaching of the civil law on this point, is a matter of probably useless speculation, so closely is the former doctrine interwoven with the fundamental questions of our legal system.

There remains to be considered one more branch of the subject—accommodation paper—whose discussion is

¹ Whistler *vs.* Forster, 14 C. B. N. S. (108 Eng. Com. Law) 248; Wookey *vs.* Poole, 4 B. & Ad. (24 Eng. Com. Law) 1.

² Bank *vs.* Welch, 29 Conn. 477; Wortendyke *vs.* Meehan, 9 Neb. 228.

thus isolated, so as not to complicate the rest of the essay.

Accommodation paper is a commercial instrument made or indorsed by one man for the accommodation or convenience of another. It is therefore devoid of consideration. In general the same rules apply to its negotiation as to other commercial paper. But there are some qualifications which should be noticed.

It is very well established that the maker of an accommodation note cannot set up the want of consideration as a defence against it in the hands of third persons, though it be there as collateral security merely.¹ "We think," said Judge Rogers, in *Appleton vs. Donaldson*, "that where a person gives another an accommodation note, it contains an authority to use it in payment of an existing debt to sell or discount it: or if more to his interest to pledge it as collateral security for money advanced at the time, or before advanced or on a running account between the parties for money advanced before, at the time or afterward. In short, that he has the complete control to use it, as the name imports, for his own benefit and accommodation, in any manner he may judge best calculated to advance his own interest. If he can prevent a suit against him by pledging the note intentionally drawn in the usual commercial form and intended to be used without restriction and by this means preserve his credit and save himself from utter ruin, there is nothing that I can see either in law or morals to prevent him.

¹ *Lord vs. Ocean Bank*, 20 Pa. 386; *Appleton vs. Donaldson*, 3 Id. 381; *Moore vs. Baird*, 30 Id. 138; *Twining vs. Hunt*, 7 W. N. C. 223; *Maitland vs. Bank*, 40 Md. 540; *Tucker vs. Jenckes*, 5 Allen, 330; *Grant vs. Ellicott*, 7 Wend. 227; *Lathrop vs. Morris*, 5 Sandf. 7; *Bank vs. Penfield*, 69 N. Y. 502; *Tucker vs. Bank*, 58 N. H. 83; *Pitts vs. Foglesong*, 37 Ohio, 676.

Of what consequence is it to the maker whether he sells the note, gives it as collateral security for a debt already contracted, or for money advanced at the time of the transaction? Accommodation paper, I take it, is a loan of the credit of the maker to the extent of the value of the note for the benefit of the payee without restriction."

However cogent may seem the reasons given by Judge Rogers in this case, they are certainly irreconcilable with the reasons assigned for the position of that same court and other courts holding the New York rule, with reference to the other kind of commercial paper. The necessity for consideration would seem to be as strong in the one case as in the other. This objection is sustained in a few States,¹ so that the exception in favor of accommodation paper is not universal; and indeed this seems to be the only consistent position for those Courts to adopt.

While the maker or indorser of accommodation paper cannot set up want of consideration as a defence, yet it is held in those last-named courts that where the payee has diverted or fraudulently misappropriated accommodation paper left in his hands for a special purpose, this will constitute a defence.² So it was held in Pennsylvania that where a bailee of a note who holds it for certain purposes, and has paid no consideration for it, fraudulently appropriated it for other purposes, no one but a *bona fide* holder for a valuable consideration could recover upon it against the maker; and a bank to whom the first holder pledged the note as collateral security for

¹ *Bramahll vs. Beckett*, 31 Me. 205; *Thompson vs. Poston*, 1 Duval, 389; *Boykin vs. Bank*, 72 Ala. 262.

² *Lenheim vs. Wilnandring*, 55 Pa. 73; *Cummings vs. Boyd*, 83 Pa. 372; *Cozens vs. Middleton*, 118 Pa. 622; *Grocers' Bank vs. Penfield*, 69 N. Y. 502.

an antecedent debt of his own is not such a *bona fide* purchaser for value.¹

Another exception in favor of the holder of accommodation paper is that he may take it after its maturity without impairing its title. Negotiation of such paper after its maturity may serve the very purpose of its making—in that way only, it may be, the intended loan or credit can be made effectual; and certainly, putting in circulation accommodation paper after its maturity, cannot be esteemed fraudulent, or *mala fides* attributed to the party who has the right of using it.² And as a corollary to the above exception, notice of the want of consideration between the original parties will not affect the title of the transferee of such paper.³

In the preceding pages there has been an endeavor to give an outline of the conflict of law concerning the title to negotiable paper held as collateral. There were shown to be the two great streams of opinion which show little sign of coalescing. That one of these must finally alter its course seems probable; and that this one will be the opinion of the courts adopting the New York rule, it is not very venturesome to prophesy. The advantages of a uniform rule on a question of such magnitude and of such wide-spread importance are manifest. Among the States themselves the jealousy of each might deny to another the right to formulate a general commercial principle. But that difficulty is removed. Com-

¹ Royer *vs.* Bank, 4 W. N. C. 86.

² Charles *vs.* Marsden, 1 Taunt. 224; Brown *vs.* Motts, 7 John. 361; Harrington *vs.* Dorr, 1 Rob. 351; Lincoln *vs.* Stevens, 7 Metc. 529; Seyfert *vs.* Edison, 16 Vr. 394; Connerly *vs.* Ins. Co., 66 Ala. 442; but *V. contra* Bower *vs.* Hastings, 36 Pa. 285.

³ Twining *vs.* Hunt, 7 W. N. C. 223; Connerly *vs.* Ins. Co., 66 Ala. 442.

merce by its nature is peculiarly the province of the national government, and it would seem the rational view, in a question of such doubt and differences, to yield precedence to the expositions of commercial law made by the national courts. The Supreme Court of the United States has expressed itself clearly and emphatically, so that there can no longer be a doubt as to what position it has assumed. Furthermore, the rule adopted there is coincident with the English rule. And, in conclusion, to quote from the opinion of Wood, J., in *Straughan vs. Fairchild*:¹ "On a subject of such general importance, and concerning which there cannot properly be a local rule, and in which the commercial world has a common interest, uniformity and certainty of decision are greatly to be desired; and since the highest tribunals in this country and in England are ruling in harmony on the point, a State court can hardly be justified in adopting, if indeed adhering, to a different rule."²

¹ 80 Ind. 598.

² *Riley vs. Anderson*, 2 McL. 592; opinion of Catron, J., in *Swift vs. Tyson*, 16 Pet. 1.

APPENDIX.

THE position of the several States of the United States upon the question as to whether the transferee of negotiable paper as collateral security for an antecedent debt is protected against prior equities arising out of it.

The States adopting the New York rule :—

Alabama.—This is almost the only State where the New York rule is consistently adhered to. *Cullum vs. The Bank*, 4 Ala. 21; *McKenzie vs. The Bank*, 28 Ala. 606; *Fenouille vs. Hamilton*, 35 Id. 319; *Haden vs. Lehman*, 83 Ala. 243. The transferee is more-over subject to defences of set-off as well as those arising out of the paper. *Bank vs. Poelnitz*, 61 Id. 147. And accommodation paper, contrary to the position of most of the States, is no exception to the rule. *Boykin vs. Bank*, 72 Ala. 262 (1882).

Arkansas.—*Bertrand vs. Barkman*, 13 Ark. 150.

Iowa.—*Trustees Ia. College vs. Hill*, 12 Ia. 462; *Ryan vs. Chew*, 13 Id. 589; *Ruddick vs. Lloyd*, 15 Id. 441; *Davis vs. Strohm*, 17 Id. 421; *Bank vs. Barber*, 56 Id. 559; *Bone vs. Tharp*, 63 Id. 223 (1884).

Kentucky.—*Lee vs. Smead*, 1 Metc. 628; *Alexander Co. vs. Bank*, 2 Id. 534; *May vs. Quimby*, 3 Bush. 96; *Greenwell vs. Hayden*, 78 Ky. 332.

Maine.—The law was originally that mere want of consideration was no defence to a note after its first negotiation. *Smith vs. Hiscock*, 14 Me. 449. The Courts afterward went the full length of the New York rule, extending it also to accommodation paper. *Bramhall vs. Becket*, 31 Id. 205; *Nutter vs. Stoevers*, 48 Id. 163.

Minnesota.—*Becker vs. Bank*, 1 Minn. 319 (per dictum *Shelburne, J.*); *Security Bank vs. Bell*, 32 Minn. 409.

Missouri.—The first position of the courts of this State was in accordance with the New York rule. *Goodman vs. Simonds*, 19 Mo. 106. They adopted the contrary doctrine in *Grant vs. Kidwell*, 30 Mo. 455; *Sav. Inst. vs. Holland*, 38 Id. 49; but have since reverted to their original position. *Brainerd vs. Reavis*, 2 Mo. App. 490; *Crawford vs. Spencer*, 92 Mo. 498.

New Hampshire.—The rule of this State is very peculiar. According to *Jenness vs. Bean*, 10 N. H. 266; *Williams vs. Little*, 11 Id. 60; *Fletcher vs. Chase*, 16 Id. 40; *Rice vs. Raitt*, 17 Id. 117, it makes no difference whether the paper is indorsed as security for an antecedent debt, or for value received at the time, for the reason that in all cases of collateral security the property or general ownership remains in the indorsee. There is, however, an exception to the rule. *Clement vs. Leverett*, 12 Id. 317; *Tucker vs. Bank* 58 N. H. 83.

New York.—The parent of the cases adopting the rule characterized by the name of this State is *Bay vs. Coddington*, 5 Johns. Ch. 54, decided in 1821 by Chancellor Kent. Unquestionably, if the same facts were presented to any court now, they would necessitate the same decision. The transferees of the security had knowledge of its defects, which of course would destroy the validity of their title. This case was affirmed in 20 Johns. 637. The question came squarely before the Court in *Stalker vs. McDonald*, 6 Hill, 93, when the last case was approved and the rule laid down, that where a creditor receives negotiable paper for an antecedent debt, either as a nominal payment or as a security for payment without giving up any security for such a debt which he previously had, or paying any money, or giving any new consideration, he is not a holder for a valuable consideration. *Potts vs. Myers*, 74 N. Y. 594; *Ins. Co. vs. Church*, 81 Id. 218. It seems to be the further rule of this State and peculiar to it and to Tennessee, that the creditor is not a holder for value if the paper is transferred in payment of a pre-existing debt. *Rosa vs. Brotherton*, 10 Wend. 85; *Lawrence vs. Clark*, 36 N. Y. 128; *Weaver vs. Barden*, 49 N. Y. 286; *Turner vs. Treadways*, 53 Id. 650; *Buhrman vs. Baylis*, 14 Hun, 608. If, however, the debt is evidenced by some writing or written acknowledgment which can be surrendered or at least cancelled, the rule is otherwise. *Bank vs. Babcock*, 21 Wend. 499; *Bank vs. Scoville*, 24 Wend. 115; *Turner vs. Treadway*, *supra*; *Ins. Co. vs. Church*, *supra*. The

general rule, however, does not extend to accommodation paper. *Bank vs. Penfield*, 69 N. Y. 502; although the contrary was once held, *Wardell vs. Howell*, 9 Wend. 170.

Ohio.—*Roxborough vs. Messick*, 6 O. St. 448. Accommodation paper is excluded from the rule. *Pitts vs. Foglesong*, 37 O. S. 676.

Pennsylvania.—The New York doctrine as to the position of a holder of paper taken in payment of a pre-existing debt is distinctly rejected in Pennsylvania; and it makes no difference whether the payment is absolute, *Struthers vs. Kendall*, 41 Pa. 214; *Hartman vs. Dowdal*, 1 R. 279; *Bardsley vs. Delp*, 88 Pa. 420; or conditional merely. *Okie vs. Spencer*, 2 Wh. 253. The general rule, however, as to the transfer as collateral security, is the same in both States. *Petrie vs. Clark*, 11 S. & R. 377; *Kirkpatrick vs. Muirhead*, 16 Pa. 124; *Lenheim vs. Wilmandring*, 55 Pa. 76; *Garrard vs. R. R. Co.*, 29 Pa. 154; *Ashton's App.*, 73 Pa. 153; *Penn Bank vs. Frankish*, 91 Id. 344; *Sitgraves vs. Bank*, 49 Pa. 364. In *Depeau vs. Waddington*, 6 Wh. 232, Rogers, J., said: "It seems to me that there would have been no great difficulty in proving that it would have been better not to have restrained the negotiability of paper *bona fide* pledged as collateral security for a debt; but on this point the law is settled." Accommodation paper stands on a different footing. Such paper is a loan of the maker's credit without restriction as to the manner of its use. *Lord vs. Ocean Bank*, 20 Pa. 386. Therefore a defence of want of consideration is unavailing. *Appleton vs. Donaldson*, 3 Pa. 386; *Moore vs. Baird*, 30 Pa. 138. While this is so, the transferee is not a holder for value, and the paper in his hands may be impeached for fraud in its making or procurement. *Royer vs. Bank*, 4 W. N. C. 86; *Cummings vs. Boyd*, 83 Pa. 372.

Tennessee.—The same rule is held in this State as in New York. *Wormley vs. Lowrey*, 1 Humph. 468; *Nichol vs. Bate*, 10 Yerg. 429; *Richardson vs. Rice*, 9 Baxt. 290. And a note transferred in payment of a debt does not place the creditor in the position of a holder for value. *King vs. Doolittle*, 1 Head, 77. The rule does not apply to accommodation paper. *Kimbrow vs. Lytle*, 10 Yerg. 417.

Virginia.—The question is still undecided in this State, although the tendency of the Court seems towards the adoption of the New

York rule. *Prentiss vs. Zane*, 2 Gratt. 262; *Davis vs. Miller*, 14 Id. 15.

Wisconsin.—*Cook vs. Helms*, 5 Wis. 107; *Jenkins vs. Schaub*, 14 Id. 1; *Bowman vs. Van Kuren*, 29 Id. 209; *Body vs. Jewson*, 33 Id. 402.

The States adopting the rule of the Supreme Court of the United States :—

California.—*Payne vs. Bensley*, 8 Cal. 260; *Robinson vs. Smith*, 14 Id. 94. In *Naglee vs. Lyman*, 14 Id. 450, Field, J., decided the question on the ground that, according to then existing laws, the creditor lost certain rights to proceed by attachment by taking security—this constituting the consideration. *V.*, also, *Davis vs. Russell*, 52 Id. 611; *Sackett vs. Johnson*, 54 Id. 107.

Colorado.—*Wyman vs. Bank*, 5 Col. 34.

Connecticut.—*Brush vs. Scribner*, 11 Conn. 388; *Bank vs. Welch*, 29 Id. 507; *Roberts vs. Hall*, 37 Id. 205.

Georgia.—*Gibbons vs. Conner*, 3 Kelly, 47; *Meadow vs. Bird*, 22 Ga. 246.

Illinois.—*Hancock vs. Hodgson*, 4 Ill. 329. Judge Lawrence, in *Manning vs. McClure*, 36 Ill. 490, gives a very clear exposition of this rule. *V.*, also, *Mix vs. Bank*, 91 Ill. 20; *Bank vs. Biaird*, 27 Id. 561; *Vanliew vs. Bank*, 21 App. Ct. 126.

Indiana.—*Valette vs. Mason*, 1 Ind. 288; *Rowe vs. Haines*, 15 Id. 445; *Stranghan vs. Fairchild*, 80 Ind. 598; *Spencer vs. Slaan*, 108 Ind. 188.

Louisiana.—*Bank vs. Gaienne*, 21 L. Ann. 555; *Giavanovich vs. Bank*, 26 Id. 15; *Gardner vs. Maxwell*, 27 Id. 561.

Maryland.—The question has not been fairly decided in this State. But where accommodation was transferred as collateral it was held that the transferee was a holder for value. *Maitland vs. Bank*, 40 Md. 540. The preference of the Court is, however, manifestly for this rule.

Massachusetts.—*Blanchard vs. Stevens*, 3 Cush. 162; *Culver vs. Benedict*, 13 Gray, 7; *Fisher vs. Id.*, 98 Mass. 303. The holder is entitled to recover only the amount of his debt out of the note,

whether it be accommodation paper or not. *Chicopee Bank vs. Chapin*, 8 Met. 40; *Stoddard vs. Kimball*, 6 Cush. 469. And if the debt is paid after the transfer of the paper, the transferee is in the same position, precisely, as the payee of the paper. *Roche vs. Ladd*, 1 Allen, 436.

Michigan.—The question has never been decided in this State, but *v. Boswick vs. Dodge*, 1 Doug. 413; *Jennison vs. Parker*, 7 Mich. 355; *Outwhite vs. Porter*, 13 Id. 533.

Mississippi.—This rule was adopted to the extent of accommodation paper. *Fellows vs. Harris*, 12 S. & M. 462. The question, so far as concerns paper which passes by indorsement, is now governed by statute, which permits the debtor to interpose all defences of want of consideration, set-off, etc., that he would have had against the payee. Sec. 1124, Code 1880; *Etheridge vs. Gallagher*, 55 Miss. 458; *Brown vs. Bank*, 62 Id. 754.

Nevada.—*Fair vs. Howard*, 6 Név. 304.

New Jersey.—*Allaire vs. Hartshorne*, 1 Zab. 665; *Duncan, Sherman & Co. vs. Gilbert*, 5 Dutch. 528; *Armour vs. McMichael*, 7 Vr. 92; *Copper vs. The Mayor*, 15 Vr. 634.

Rhode Island.—*Bank vs. Carrington*, 5 R. I. 515; *Crabb vs. Doyle*, 7 Id. 550.

South Carolina.—*Bank vs. Chambers*, 11 Rich. 657; *Deerman vs. Trimmier*, 26 S. C. 506.

Texas.—*Greeneaux vs. Wheeler*, 6 Tex. 515; *Liddell vs. Crain*, 53 Id. 555; *Kaufman vs. Robey*, 60 Id. 308; *Bank vs. Turnley*, 61 Id. 369.

Vermont.—In *Atkinson vs. Brooks*, 26 Vt. 569, Ch. J. Redfield laid down with great clearness the rule of the Supreme Court of the United States. That case was in effect overruled in *Austin vs. Curtis*, 31 Vt. 64. But that *Austin vs. Curtis* is not a final settlement of the question, *v. Griswold vs. Davis*, 31 Vt. 390. And in a recent case the Court, without overruling *Austin vs. Curtis*, accepts the doctrine of *R. R. Co. vs. Nat. Bank*. *Noyes vs. Landon*, 59 Vt. 569.

The question therefore remains open in Delaware, Florida, Kansas, Minnesota, Nebraska, North Carolina, Oregon, Virginia, and West Virginia.

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Author

Vol.

Smith, Lewis Lawrence

Title

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The transfer of negotiable
~~paper as collateral...~~

Date

Borrower's Name

